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UNCLAS SECTION 01 OF 03 MEXICO 001627

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STATE FOR WHA/MEX, WHA/EPSC, EB/IFD/OMA, AND DRL/AWH
STATE FOR EB/ESC MCMANUS AND IZZO
USDOC FOR 4320/ITA/MAC/WH/ONAFITA/GERI WORD
USDOC FOR ITS/TD/ENERGY DIVISION
TREASURY FOR IA (ALICE FAIBISHENKO)
DOE FOR INTERNATIONAL AFFAIRS KDEUTSCH AND SLADISLAW
NSC FOR CYNTHIA PENDLETON
STATE PASS TO USTR (EISSENSTAT/MELLE)
STATE PASS TO FEDERAL RESERVE (CARLOS ARTETA)

E.O. 12958: N/A
TAGS: [ECON](#) [ELAB](#) [EFIN](#) [PINR](#) [PGOV](#) [MX](#)
SUBJECT: MEXICO,S SENATE APPROVES PENSION REFORM

REF: A. MEXICO 1389

[1](#)B. 06 MEXICO 2220

Summary

[1](#)1. (SBU) The Mexican Senate approved draft legislation to reform the Social Security and Services Institute for State Workers (ISSSTE), the agency responsible for providing pension and health care services for most government employees. The bill, which has already passed in the lower house, still has to be signed by President Calderon and published in the Official Gazette to become law. The Senate did not make changes to the bill, but lawmakers introduced a separate initiative to reform the Savings Retirement Law. This bill, among other things, establishes more requirements for the person that will head ISSSTE's pension fund managing company. Despite its relatively easy passage, the bill spurred protest marches and was criticized by the political left. While the transition costs of changing pension systems will be high, the government will bear these costs over time. While the bill's passage and eventual implementation will mark a major success in Mexico's reform efforts and will help build momentum for other much-needed reforms, it remains to be seen if the Calderon government can reform the pension systems of other civil service employees that have financial problems. Pemex alone has more than US\$ 50 billion of unfunded pension liabilities. End Summary.

Pension Reform Bill Awaits President's Signature

[1](#)2. (U) The Senate this week voted 85-32 to approve a landmark government workers' social security reform that gradually raises the retirement age and replaces the current

"defined-benefits," pay-as-you-go pension system with a fully funded system of individual accounts (see Ref A). The bill, which has already passed in the lower house, still has to be signed by President Calderon and published in the Official Gazette to become law.

13. (SBU) The Senate did not make changes to the bill, but lawmakers introduced a separate initiative to reform the Savings Retirement Law. This measure passed in the Senate with a vote of 77-22, and is currently awaiting approval in the Chamber of Deputies. The bill establishes more requirements for the person that will head Pensionissste, the pension fund managing company (Afore) for these new individual accounts. This measure is designed to protect Pensionissste from appointments linked to National Teachers' Union (SNTE) leader Elba Esther Gordillo and other political interests. Currently, employees can only switch to another Afore once a year. This bill would allow them to switch before the year is over to an Afore that offers a higher net yield. The proposal opens the door to allow changes more than once a year. The bill also modifies the way Afores charge fees. Instead of charging fees on both the flows and balance of the accounts, they would only be able to charge fees on the balance. The Managing Director to the President on Strategy at the Mexican Stock Exchange, Alejandro Reynoso, (strictly protect) on March 28 told Econoffs that the bill is intended to make Afores more transparent, increase the returns to workers, and foster competition among Afores.

Reaction to the Reform Measure

14. (SBU) Despite its quick passage, the bill spurred protest marches led by the nation's largest unions, including those

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representing university workers, telecommunications employees, and the umbrella workers organization known as the National Workers' Union (UNT). Protesters marched on the Senate building in Mexico City's historic center and clogged up traffic along one of the city's main thoroughfares. Opposition to the reform, largely led by the Democratic Revolution Party (PRD), is based on the belief that the changes amount to a privatization of the pension system. Interestingly, a senior staffer in the Senate's Finance Committee told Econoffs that many of the people who have opposed the measure (referring to PRD) are actually in favor of the reform because they understand the importance of having it approved. He said they voted against the bill to maintain "political lines."

15. (SBU) However, a labor activist closely linked to the PRD commented on the irony of the fact that a massive police presence was needed to protect the Senate building while the legislators debated the reforms. During a labor conference held when the Senate was debating the bill, a speaker rhetorically asked the attendees why it was necessary for the police to protect the Senators from the workers while they were debating a law that would supposedly benefit the workers.

16. (SBU) A spokesperson for the PRD's National Executive told Post's Labor Counselor that his party had three major concerns about the ISSSTE reform. First, he said, the reform legislation was being hailed as a fiscal savings when in fact it only shifts cost of pensions from one part of the federal government to another and then, using the much lauded bonds, postpones that cost. Second, the spokesperson said the reform was based on the privatized system implemented in Chile, which looked good at first but ultimately reduced pension benefits through the high costs of related banking services. Third, the PRD representative stated, if the ISSSTE reform is allowed to be implemented as is, the Mexican government would then try and do the same thing with Pemex's retirement system, thereby "harming" even more workers.

¶7. (SBU) Some politicians and analysts have criticized the "requirement" that Pensionissste invest in domestic infrastructure projects, which can be risky. The Senate staffer told Econoffs that this requirement was not included in the legislation because it would have been difficult to put such restrictions in a law. He said that Pensionissste's board will be responsible for deciding how funds will be invested.

Fiscal Implications

¶8. (SBU) Samuel Aguilar Solis, secretary of the Chamber's Social Security Committee, said publicly that the cost of reforming ISSSTE will reach US\$183 billion and exceed 20% of GDP. The Senate staffer told Econoffs that the reform will have "a zero fiscal cost" at the time it is approved because it does not include immediate expenditures. He said that the government will incur the costs gradually. The bonds issued to savers who decide to switch to the new system will represent a cost, but this burden will be spread out over time since payments are only made when a person retires. The expenditures for workers about to retire have already been taken into account, so they do not represent an additional cost. The staffer noted that the fiscal benefits of the reform will be seen in the long term, and that without such a reform, liabilities would eventually represent 40% of GDP. He added that future workers will gain because if changes are not implemented, eventually the government would be unable to pay pension benefits.

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Benefits

¶9. (SBU) Reynoso said that the ISSSTE reform is important not only because of the reduction in pressure on public finances and the political consensus achieved, but also because of how it will benefit financial markets. ISSSTE's assets to be invested total US\$550 million, while the bonds granted by the government represent an additional US\$3.7 billion that will be gradually introduced into the secondary market.

¶10. (SBU) A number of contacts told Econoffs that this reform will help build momentum for other much-needed initiatives, such as a revenue-enhancing fiscal reform and Pemex reform. The Senate staffer thinks that the government will push fiscal reform next because the more resources the government collects, the more the government can reduce Pemex's tax burden. He was confident that political consensus on these reforms can be achieved, but both he and Reynoso expect the fiscal and Pemex reforms to be less "spectacular" than the ISSSTE reform.

Comment

¶11. (SBU) This bill's passage and eventual implementation will mark a significant achievement in President Calderon's reform agenda. While it will also be significant progress in defusing Mexico's ticking time bomb of unfunded pension systems (Ref B), the government will need to reform the equally or more troubled pension systems of state government employees and those government organizations whose political clout have blocked critical pension reform, including employees of the Mexican Social Security Institute (IMSS), Pemex, the Federal Electricity Commission, Nacional Financiera, and public universities. Pemex has more than US\$ 50 billion of unfunded pension liabilities, and the situation for IMSS employees is significantly worse. The workers in all of these organizations will most likely resist an ISSSTE-like reform. Pemex workers and the electricity

commission unions have considerable financial resources, and the universities and state governments have large staffs that can and will take to the streets in protest. Overcoming money and willing foot soldiers will be a daunting task for Calderon's government.

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